

Is this a good time to start investing in sugar stocks?

Better prices and lower inventory-carrying costs make fundamentally strong stocks a good choice

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The Centre has introduced a slew of measures over the past month to help the ailing sugar sector. These include the move to create a buffer stock of 40 lakh tonnes of sugar for a year from August 1, 2019, provide an export subsidy of ₹6,268 crore for manufacturers and increase ethanol price.

Reduced market surplus, lower inventories and better prices can help sugar makers. The outlook for the next two years appears sweet for players such as Balrampur Chini Mills, Dwarikesh Sugars and Dhampur Sugar Mills.

Sugar output hit a record 325 lakh tonnes in the sugar season (October-September) of 2017-18



and, in 2018-19, scaled a new peak of 329.5 lakh tonnes. With consumption remaining stagnant, the inventory increased. The 2019-20 season is set to open with a stock of 142 lakh tonnes, which is over half of what India consumes in a year.

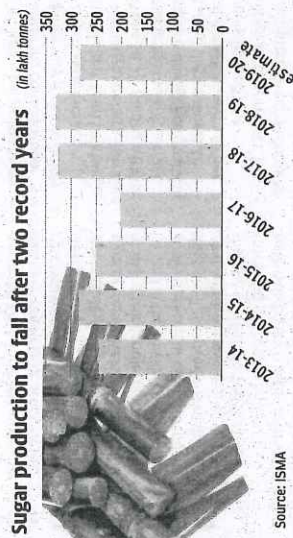
However, cane output is expected to come down due to poor rains in key-cane growing states, including Maharashtra and Karnataka. The Indian Sugar Mills Association (ISMA) expects production in 2019-20 sugar season (SS) to be about 282 lakh tonnes, down 14 per cent from the previous year.

Given the Centre's measures on the export front, the surplus carried forward to 2020-21 may reduce. The sugar export subsidy of about ₹6,268 crore is for 60 lakh

tonnes, down 14 per cent from the previous year.

Surplus situation
Nonetheless, there will be a huge surplus of sugar in the market in

Sugar production to fall after two record years



Source: ISMA

2019-20 too. After domestic consumption of 260 lakh tonnes, the country will have a surplus of about 164 lakh tonnes that the industry can export or use for conversion into ethanol. The balance will be carried forward to the 2020-21 sugar season.

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tonnes of sugar. A back-of-the-envelope calculation shows that the export sop works out to ₹10,446 per tonne of sugar or ₹10.44 per kg. Currently, in the export market, sugar prices are hovering at ₹20/kg and the domestic market MSP is ₹31/kg. The average cost of production for the industry is ₹36/kg.

Thus, taking the subsidy into account, the cost for mills will come down to ₹26/kg.

Still, the export market price at

₹20/kg implies that the mills will be exporting at a loss.

That said, speaking to sugar mills, *Businessline* finds that they may still be keen to reduce their inventory by exporting so as to reduce working-capital and save on costs. Also, while exports look unattractive now, in the next few months, prices may rise.

Price direction – positive

Global sugar prices have been under pressure since June. However, prices may go up in coming months as demand-supply balance in the global market is set to tighten. Analysts, globally, have recently revised the deficit quantum higher from their initial estimates in May/June.

This follows lower sugar production expected in EU, Australia, Thailand, Pakistan and India. In the domestic market, the supply of sugar till July 31 next year will be lower by 40 lakh tonnes, thanks to the Centre's move to support mills to keep buffer stock. Alongside this, a

rise in exports lowering supply in the market, will be positive for prices. Sugar prices may remain stable around ₹3,250/quintal or even rise marginally.

Sugar stocks – a good bet

Domestic sugar manufacturers may see margins improve in the next one year – better prices and lower inventory carrying cost will help.

Also, given that many players including Balrampur Chini and Dwarikesh Sugars, are focussing on higher ethanol production, profit margins can scale up. It may be a good time to pick up fundamentally-strong stocks in the sugar space.

Mills from the South may be avoided, as they are hit by lower cane availability and drop in capacity utilisation. Mills from UP – Balrampur Chini, Dhampur Sugar Industries and Dwarikesh Sugars – may be a good choice.

In the June quarter, Balrampur Chini reported a 5 per cent drop in

revenue due to lower sales volume, but operating profit was higher by 36 per cent Yo-Y, thanks to higher realisation, improved operational efficiency and higher sugar recovery. The company's distillery capacity is set to increase by the end of this fiscal with work on the new 160 KLPD facility in progress.

Dwarikesh Sugars and Dhampur Sugar Mills also saw a decent June quarter, helped by higher realisations in sugar. For Dwarikesh, profits and margins declined last year, because of lower revenue from the power segment due to drop in tariffs by the government.

The company is expanding its distillery facility, which will be operational by November 2019. Dhampur Sugar's debt burden appears to be easing. In the June quarter, it repaid outstanding long-term loans of ₹32.45 crore and reported a long-term debt-to-equity ratio of 0.55.

Most of these stocks trade at a discount to their three-year average price earnings.

Hindu Businessline

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